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VIEWPOINT

HOW CONDITIONAL APPRAISALS COULD REDUCE LOAN CLOSURE TIME

Mortgage appraisals in the US still take weeks to complete. Technology-driven processes can reduce this duration to hours. However, the uptake is currently low. Everyone in the mortgage ecosystem, from buyers and lenders to appraisers, should be ready for this cultural switch.

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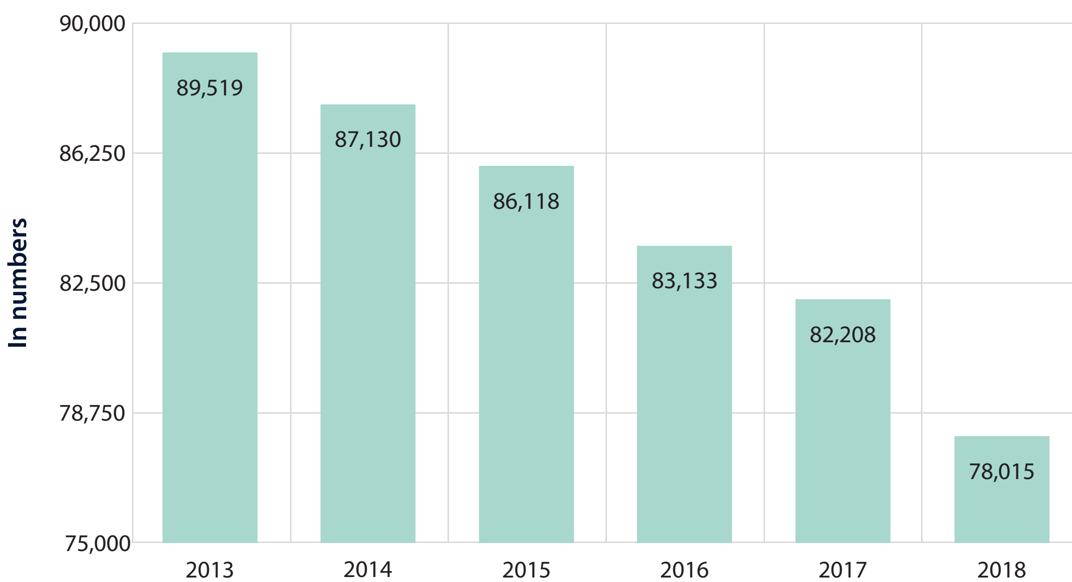
Two factors led to the 2008 financial crisis – relaxed credit lending and underwriting standards in the US. Since then, both factors have tightened up to the extent that the pain of taking out a mortgage draws the joy out of buying a house. Complications that slow down the process range from insufficient credit history of the would-be buyer to time-consuming manual mortgage appraisals and underwriting.

In April 2022, the average time to close a mortgage in the US was 48 days.[1] Of this, mortgage appraisals, a key activity, can take between seven and 10 days.[2] An appraiser shortage, an aging appraiser population, and the need to physically visit the property have impacted the time to complete appraisals. The number of appraisers in the US declined by an average of 3% between 2013 and 2018.[3] Appraisals still cost between USD 300 and USD 800, depending on the property size.[4] This cost can double or triple if the would-be buyer wants a quicker appraisal. A physical visit that involves meeting the seller could also lead to bias creeping into the home evaluation, resulting in a lower appraisal value. Appraisers also perform loads of manual documentation and verification, which are time consuming and error prone.

Technological advances have entered the financial services business, yet the uptake in the mortgage segment is low. Appraisal technology and systems are archaic and siloed, which delays the entire mortgage workflow. If technology is implemented the right way, mortgage appraisal and underwriting will become easier, quicker, and safer in the US.

Figure 1: Declining number of appraisers in the US



Source: Appraisal Institute

Changing regulations

To ease the burden on appraisers, the Federal Housing Finance Agency (FHFA) has allowed desktop appraisals from March 2022.[5] The federally backed mortgage companies Fannie Mae and Freddie Mac now accept desktop appraisals with information from existing sources such as appraisal reports, multiple listing services (MLS), and public records. MLS contains information about properties for sale from real estate brokers.

However, appraisers remain concerned about incomplete or unreliable property information without physically seeing the property. They need to rely on floor plans more than ever before. Appraisers worry about the trustworthiness of using a third party to gather evidence and assess the condition of a property. For instance, sometimes, property photos in the MLS do not match the actual property.

The 'art' and 'science' of appraisals

What happens when the appraisal value is lower than the buyer's offer?

The buyer either pays a higher down payment, backs out of the contract with the seller, or renegotiates the price. These situations are inconvenient for everyone involved and require time, money, and effort.

> The right technological implementation will make mortgage appraisal and underwriting easier, quicker, and safer

Yet this shouldn't be the case. It's generally agreed that property appraisals are mostly a science with data-led assessments – identifying and verifying the location and size of the property, checking tax and municipality records, and comparing previous sale prices of similar nearby properties – with a dash of art and intuition based on previous experience and the appraiser's expertise. That includes understanding market trends to arrive at a fair and accurate property valuation. With technology, the time, effort, and cost of the science of an appraisal can be reduced considerably and allow appraisers to concentrate on the analytical aspects.

Enabling a conditional appraisal

Can appraisers obtain reliable data without a physical property visit?

Lenders can offer buyers a conditional appraisal that involves a live video walkthrough of the property with the appraiser, and photos of house sections that are more susceptible to wear and tear or involve maintenance (such as loft, roof, and basement). Property videos and photos are kept for evidence and future reference. This is similar to how Kelly Blue Book and CarMax quickly evaluate vehicles. If the appraiser is satisfied with the data gathered, they can provide an instant fair value of the property. Otherwise, the appraiser can request a physical appraisal or an inspection.

A conditional appraisal would most effectively work when the property is new, and the buyer expects a higher appraisal value than the seller's listing price. In a new property, the chances of wear and tear are less, and comparable data

of similar properties become crucial. New properties in the US also come with a warranty period – five years for the foundation, one year for appliances, and 30 days for scratches or fixing minor and visible defects. However, the period may vary depending on the state or builder. A conditional appraisal can be a win-win for all parties involved — lenders close more loans, appraisers conduct more business, and buyers benefit from quicker, cost-effective appraisals.

A cultural and technological shift

Higher mortgage rates of over 6% and a shortage of homes for sale are eating homebuyers' budgets.[6] The mortgage market is sluggish, with home sales falling for a sixth straight month in July 2022 and the median sales price dropping to USD 403,800 from a record USD 413,800 a month earlier – the first decline since January 2022.[7] While loan volumes are dropping, forward-looking lenders will use this time to streamline processes, optimize costs and invest in technology.

APIs can fetch county records of the property, comparable property listings, and recent MLS listings for appraisers who require these data for property document validation and certification. Intelligent automation can also handle steps that do not require manual interference. Machine learning-based document classification can help in cases where documents lack proper file names or identifiers. Data verification and processing can be automated through features such as optical character recognition that easily validate the veracity of data provided by the would-be buyer by comparing it with municipal records. IoT devices could provide appraisers with information about water leakages in the house that are otherwise difficult to detect.

Homebuyers could be encouraged to take up the option of a virtual appraisal during the loan application process and kickstart the appraisal process by providing home lenders property descriptions, photos, and additional information at the time of application. That information can then be directly fed into the application and provided to the appraiser, quickly generating the appraisal value.

However, this requires a cultural change from appraisers and lenders. Appraisers should be flexible and aware of new processes, while lenders need to build new systems that can obtain data from buyers and feed them to appraisers. While regulators have warmed up to remote appraisals, they should review and evaluate the advantages of conditional appraisals versus the risks.

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